MINUTES

BOARD OF TRUSTEES
PUBLIC EMPLOYEES' RETIREMENT FUND
143 West Market Street, Suite 602
Indianapolis, IN 46204

August 27, 1998

TRUSTEES PRESENT

Richard Doermer, Chair
Nancy Turner, Vice Chair
Dr. Teresa Ghilarducci
Steven Miller
Jonathan Birge

OTHERS PRESENT

Doug Kinser, Executive Assistant to the Governor
Diana Hamilton, Special Liaison to the Governor for Public Finance
Mary Beth Braitman, Ice Miller Donadio & Ryan
Kris Ford, Wm. M. Mercer Investment Consulting
Pete Keliuotis, Wm. M. Mercer Investment Consulting
Richard Boggs, Burnley Associates
Dan Rives, Indiana University
Karen Franklin, National City Bank
Faith Berning, National City Bank
Irwin Krueger, PERF Retiree
Mark Webb, PERF Interim Director
Patrick Lane, PERF Executive Assistant to the Director
Bill Hutchinson, PERF Division Director, Pension Administration
Dave Yeater, PERF Controller
Tom Parker, Director, 1977 Police & Fire Fund
Linda Petro, Recording Secretary

ITEMS MAILED TO THE BOARD PRIOR TO MEETING

A Minutes of May 18, 1998 Meeting and June 1 & 2, 1998 Meeting
B. Statements of Retired and Disabled Members - PERF, Judges' Retirement System, Conservation & Excise, and Police & Fire

A quorum being present, Chairman Doermer called the meeting to order.

1. INTRODUCTION OF NEW BOARD MEMBER

Chairman Doermer began the meeting with the introduction of Jonathan Birge, the newest member of the Board of Trustees. Mr. Birge is a Partner with the law firm of Bingham Summers Welsh & Spilman and practices in the areas of corporate, banking and administrative law. His education includes a B.A. from Yale University and a L.L.B. from the University of Michigan.

2. APPROVAL OF MINUTES

Following review by the Board,

MOTION duly made by Teresa Ghilarducci, seconded by Steve Miller and unanimously carried to approve the Minutes of the May 18, 1998 and June 1 & 2, 1998 meetings.

3. UNIT TRUST ACCOUNTING

Karen Franklin and Faith Berning were present representing National City Bank.

Ms. Franklin presented to the Trustees samples of the reports National City proposes for monthly preparation for the unitized accounting. Those sample reports consisted of a full manager report which comprises the assets owned in the plans. All of the individual manager accounts have a net asset value struck for the day, and the plans are then valued based on the contributions and distributions. Additionally, there were seven underlying statements for each of the plans administered by PERF. These reports will be provided monthly in statement form to include trade date with accruals. Additionally, the PERF Controller will be provided monthly with a combined rollup report. In that are all of the underlying numbers he will use to calculate income, accruals, and help provide financial statements. "The Fund is now on current industry standard with the managers, the PERF Controller, and the PERF consultant receiving trade date statements. There is a little bit of residual funding to be completed, but PERF is well on their way to being in the equities market."

Chairman Doermer requested that Ms. Franklin refresh the Trustees' recollections on settlement date accounting versus trade date with accruals. Ms. Franklin responded that previously the Fund was on settlement date without accruals. Settlement date is the day that a trade actually settles versus trade date which is the day a manager actually buys or sells a trade. The difference is that on trade date the manager, when he reports his performance, reports it as of trade date. He also includes accruals because if he were to sell the security he would get the accrued interest. That was not reported previously. It was reported once a year on a settlement date basis --- now it's reported as a part of the market value every month.

Chairman Doermer inquired of the PERF Controller if the proposed reports served all his needs. Mr. Yeater responded that the Fund has gone through a time period where there has been a lot of movement of money and a short period of time where there was a transition from the old format to unitized accounting. Basically, in mid-August the Fund had June 30 information.

> We are comfortable with where we are. We are putting financials together. We are going to have those completed for all funds in about 1-1/2 weeks. We've got the mission accomplished for June 30. Moving from that to where we're going, my answer is that these reports provide most of the information we need. By the same token, not having a staff large enough to do a lot of the investigative work, a lot of this has to be used for support. So as long as we're in agreement that we can ask for further summary reports and things of that type to meet our needs as we move to trade date and reconciling and moving now into July of 1998, my answer is 'yes'. But, I will need some things other than just those reports. I can't rely on just all this paper with the amount of people I have to get to where I want. These things are what we need for support, but I do want to move more to some of this being in some kind of a spreadsheet or summary basis.

Mrs. Braitman added, to put everything into context, that the direction the Board has wanted to go is to streamline and simplify so that things coming in from the investment managers are consistent with things going out to the State Board of Accounts, consistent with things going to Burnley Associates and Wm. M. Mercer Investment Consultants, etc. The State Board of Accounts has been very, very supportive of that process. One of the things the Benefits Committee has discussed is to look at the National City recommendations and go with those subject to the approval of the State Board of Accounts. That would give the ability for Mr. Yeater to be sure that the State Board of Accounts is comfortable with what is proposed.

Following some further discussion,

MOTION duly made by Steve Miller, seconded by Jonathan Birge and unanimously carried to approve the reporting formats as presented by National City Bank subject to the satisfaction of the State Board of Accounts.

4. DISCUSSION OF INTERVIEWS WITH EXISTING MONEY MANAGERS

Richard Boggs, Burnley Associates, reported on the manager interviews conducted on August 27.

Banc One has had a good year; however, some of the numbers weren't quite as good longer term. PERF's Investment Guidelines permit a down of 20% from the LBA and an up of 20%, and Banc One says they would tend to use that. What they did indicate was they would go to those extremes only about 10% of the time --- 90% of the time they'll be minus 10%, plus 10%. They will, as a matter of strategy, typically be overweighted in mortgage backed securities and in corporates. During the past twelve months they have been carrying a higher mortgage backed security portfolio than is in the index, and they have carried more corporates. When you look at their performance against the benchmark over the past twelve months, they are 26 basis points below that benchmark. There is really no single factor that jumps out as the reason. They explained their under performance over the past 12 months by saying they were somewhat close to the LBA duration and that they have carried strong mortgage backs which hurt them in the last quarter and strong corporates which helped them in the last quarter. It's a mix of pluses and minuses, and it is really not easy to explain why they were down 26 basis points. When you try to view them as a manager, you simply say they are one that certainly over the last three years were negative and over the last five years were positive. Net of fees they were about flat.

Mr. Miller suggested that the Board not get too hung up on short periods of performance. The managers should be looked at to see if they are in the ball park or drastically under performing, and, if so, why. "I think we should focus mostly on whether they're doing it the way we want them to do it?" He noted that Banc One is essentially doing what they were hired to do. They are spreading their investments across a pretty broad sector weighting in the bond market. They may have been down 26 basis points simply because they didn't buy the right corporate bonds. Their structure may have been more or less barbelled. Those things are judgments which are going to fluctuate back and forth from quarter to quarter.

Mr. Boggs continued with a review of HM Capital. HM has been consistently short in their durations and 100% in treasuries. In discussion today they told Mr. Boggs that over 16 years of managing money, 25% of the time they have been longer than the LBA. They argue that some of the time they are longer even though three-fourths of the time they are shorter, and they should not be pigeon holed as someone who never has the fortitude to go to the LBA or longer. They confess to making a simple strategic mistake of thinking that interest rates were going to rise over the last two years. They were wrong. They are 100% treasuries. Mr. Boggs inquired of HM what their highest mortgage backed and corporate position had been in the 16 years they have been in business. Their response was that over time they have been as high as 50% mortgage backs and, not simultaneously, as high as 40% corporates. They have made another strategic error. They said that spreads were not going to narrow in mortgage backs and corporates over the last years. They were wrong there also. HM made a number of decisions which could not have been more wrong.

Ms. Ghilarducci inquired if HM is going to continue to make decisions predicting what interest rates will be to which Mr. Boggs responded that they said they will continue that strategy. They indicated that with what has happened in the marketplace, they have picked up 60 basis points to the LBA since June 30. They were down 20 through June, then picked up 60, and they said that if today were the end of an accounting period, everyone would be smiling because they would be ahead of their goal year-to-date by 40 basis points. The question then is over what time period do they stay short so that there's a catch up effect? If the Fund suffers their being wrong for two years, then they had better be right long enough so that one time period overwhelms the other one and they start to march ahead of their goal over a meaningful time period. They currently are not, so they have to hope for that to hit before the Fund finally evaluates them or loses all confidence in the interim.

Mr. Miller commented that when you look at a firm who generally likes to sit around long to the index, by and in large they are going to do well more times than they will underperform because they will be long to the index and it will help them. So someone who sits there consistently a little long to the index is not taking interest rate bets as much as someone who is short to the index. When you are short to the index by 15-20%, you are saying that you know that even in spite of an upward shape yield curve, rates are going up and you're going to go short. They are making a bet.

> That's how I view HM Capital. They are taking a huge bet on interest rates, and they think sooner or later they are going to hit a home run. The other thing is that if the curve does steepen and they continue to set short, they are going to roll down the curve a little and eventually get below their duration target.

Mr. Boggs noted that three months ago HM was 21% under the duration target — now they are 15% under. Mr. Miller continued that as long as they are within the Fund's ranges, they cannot really be accused of violating duration ranges while, in spirit, they are because what they are doing is not what the Fund wants their fixed income managers to do.

Kris Ford inquired if HM Capital was, in fact, sector rotators. She noted that there are some managers who will stay 100% in the government sector because their strategy really does, indeed, focus on interest rate and yield curve placement and they won't go out because of resources or strategy. Mr. Boggs responded that he had asked that direct question of HM, and they told him that over their corporate history of 16 years they have been as high as 50% mortgage backs and in a different time period they were as high as 40% corporates. If they only did that once and have been zero ever since, that's kind of giving a disingenuous response because that's not the spirit in which it was asked. Ms. Ford continued that the question then should be if they have changed their strategy or is there a resource issue that they don't feel they can adequately approach those markets any longer.

Mr. Miller indicated that he would like to see a longer term history of their sector allocation. He noted that when someone takes these kinds of bets they have to live with the fact that sometimes they are going to do well, but a lot of times they are not. "That's what happened to HM. The problem is that it's not their money, it's the Fund's money." Following some further discussion, it was recommended that HM be asked to appear before the Investment Committee at their next meeting on September 29.

Mr. Boggs continued his discussion of existing money manager interviews with Hughes Capital Management. Hughes was ahead of the LBA with a mix of longer duration, although they say that's not a primary consideration at all, and an over weighting in corporates. Their duration was modestly longer during those time periods when it should have been. It was noted during the interview that Hughes has virtually doubled their client base in the last 12 months. With respect to staffing, they had one person leave who was replaced by two people; thus, they've had an addition to their staff of one person. Prior to this time there has been no full-time backup portfolio manager. The gentleman now hired to act in that capacity has five years of hands-on investment experience. Prior to that he was a commercial banker so he feels that he does a good job on credit analysis. He replaced someone who was a little less qualified. An administrative person was also added to staff.

The managers interviewed who had no performance to discuss were two of the new equity managers --- Dimensional Fund Advisors and J. P. Morgan. J. P. Morgan runs two portfolios for PERF, the large cap enhanced and the small cap enhanced. The large cap enhanced was fully funded on August 21. The small cap is not fully funded but will be over the next two months. About two-thirds of their trades were crossing trades which do not incur commission costs. Dimensional Fund Advisors is fully invested with the $240 million they were given. They are still awaiting another $160 million which will be coming in over the next couple of months. Of the $240 million, $55 million was crossed. PERF will be DFA's largest client in this specific style. They have only six separately managed accounts in this style.

5. PERFORMANCE ANALYSIS AND CASH FLOW ALLOCATION

Through the second quarter year-to-date the market was up 17%. During the quarter the Fund was up 2.6% and the equity weighting was 26%. None of the stock managers had any meaningful rate of return calculations. The index fund tied the index and the bond managers fell within a range in the quarter that was within 70 basis points low to high. Over the six months year-to-date there was a 90 basis points range low to high.

The worse manager was HM Capital --- the best were NCM and Prime. Over the last year Prime has been up 69 basis points. It has been long duration that's helped them by being low in mortgage backs and carrying, over much of that time period, long corporates. They are 20% of the Fund's assets (in the Prime A and the Prime B accounts). The Investment Committee has suggested that after the Prime A account is brought down to the $500 million level, all contributions from bonds into stocks should be taken out of the Prime B account, and the Prime B account then would be brought down to zero.

Concerning cash flow for the 4th quarter 1998,

MOTION duly made by Nancy Turner, seconded by Steve Miller and unanimously carried that until determined otherwise, all cash flows will go in and out of the Reallocation Fund.

Mr. Boggs continued with discussion of guideline violations. There were three violations that did not relate to the cash collateral portfolio. Harris continues to hold some Korean Development Bank bonds which were downgraded. They have not been upgraded but are still one notch below. Morgan purchased a 144A (private placement) which, in the Fund's strict interpretation, they should not have had. It was brought to their attention — they sold it and realized a small gain of $4,500. Additionally, there is a guideline on duration of plus or minus 20%, and Pacific was 21%. They know the Fund is not happy with that.

With respect to securities lending, Mr. Boggs reported that he continues to have problems with Chase Manhattan. They still hold some issues consisting of 7% of the cash collateral portfolio which are being held in the same kind of 144A (private placement) as that Morgan purchased. When Morgan was told that strict interpretation of the guidelines indicates a violation by holding such issues, they sold them. Chase, however, wants to argue about it. Tom LaLonde, National City Bank, is also unhappy with the issue. Mr. Miller inquired if this was a pooled cash collateral, and Mr. Boggs responded that the Fund had insisted on a separately managed account. Mr. Miller inquired further as to why Chase then argues. Mr. Boggs responded that the problem with performing at base fees is that they get the gain and don't share the credit risk. PERF gets 100% of the credit risk — they get 35% of the income. National City is proposing that they do the cash collateral portfolio like their sweep fund which means that every night uninvested money from all of the managers would be swept into a separately managed money market fund which is run just for the Fund within its guidelines. The overnight interest is somewhere around $250 to $300 per million.

Following some further discussion.

MOTION duly made by Steve Miller, seconded by Teresa Ghilarducci and unanimously carried to direct National City Bank to proceed, as soon as they feel they are able, with replacement of Chase Manhattan.

6. <u>REPORT ON POLICE & FIRE CONVERTEES MOVE TO 1977 FUND</u>

Tom Parker, Director of the 1977 Police & Fire Fund, reported that during the last legislative session a statute was passed which would allow approximately 1,200 police and fire pensioners to transfer to PERF. The main purpose of the statute is to alleviate the unfunded liability problems of the old police and fire pension plans administered by the local units. In many cases the local units do not have the money to actually start these pensions or continue to pay them. Thus, PERF is, in essence, taking a major burden off of them financially and will be picking up those benefit payments in October. PERF staff is currently in the process of collecting the necessary data from the local units and reviewing it for completeness and accuracy. An additional staff member has been hired to help with the completion of the project.

7. <u>REPORT ON PROGRESS OF MID-CAP BROAD AGENCY ANNOUNCEMENT</u>

Mr. Webb reported that on or about August 10 a total of 54 replies to the Broad Agency Announcement ("BAA") were received. A copy of the investment policies and the contract a potential manager would be expected to sign were included as part of the BAA. The reports were delivered to the PERF offices last week and copies of each report have been distributed to Wm. M. Mercer Investment Consulting and Burnley Associates. Mark Webb, Patrick Lane, Dick Boggs and Kris Ford will do the initial evaluations. All the managers who do not meet the minimum qualifications will be eliminated and the remaining will be reviewed through third and fourth round selections until six or so value and growth managers are recommended for interview by the Board. It is intended that those interviews will be conducted at the next meeting of the Board of Trustees.

Mr. Boggs noted that a similar process as that used for the last Broad Agency Announcement would be utilized wherein the entire group of respondents were screened and then narrowed down to a selection of managers which was presented to the Investment Committee for review. They then whittled it down from perhaps 10 to 2-3 in each style for interview by the Board. Mr. Miller recommended that every effort be made to get the total down to no more than 6 managers who would be interviewed by the Board.

8. ANNUITY SAVINGS ACCOUNT CONVERSION PROCESS

Patrick Lane, PERF Executive Assistant to the Director, reported that a Call Center has been created to handle questions concerning annuity savings account options. The Center is currently taking less than 50 calls per day due to the fact that people have traditional outlets of information and will call and inquire of individuals from whom they have previously received assistance. Therefore, the calls are not centralizing in the Call Center; however, as communication efforts move forward there will be more aggressive advertisement of the Center with a commitment to making it more user friendly.

With the Call Center experiencing a large down time, those resources were put to use to assist the Data Processing Department in changing investment direction forms, updating addresses, etc. The mailing earlier completed to all PERF active membership generated a return of approximately 10% due to address problems. With the Fund moving toward quarterly mailings, that becomes an important issue. To date, the Call Center has been changing addresses and remailing over 100 pieces of mail per day. Thus, an address clean-up project is being undertaken with a wide variety of positive effects for the agency.

The number of investment direction responses has been surprisingly high. Approximately 200-300 investment direction forms are being received daily. Some problems have been experienced with the incorrect completion of the forms. Those forms are being returned to the members for proper completion and resubmission.

9. RECESS

With no further business, the Board recessed to reconvene at 8:30 on August 28.

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Mary Pettersen, Teachers' Retirement Fund
Irwin Krueger, PERF Retiree
Mark Webb, PERF Interim Director
Patrick Lane, PERF Executive Assistant to the Director
Diann Clift, PERF MIS Director
Dave Yeater, PERF Controller
Bill Hutchinson, PERF Division Director, Pension Administration
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1. Year 2000 COMPLIANCE REPORT

Diann Clift, PERF MIS Director, began by discussing the impact of the year 2000 problem and what is being done on a national and state level and at PERF to prepare.

The year 2000 problems began in the 1960's. Data storage space was very expensive and the programmers thought they would save some money by storing the last two digits of the year. They thought the systems being developed at that time would not last 30 years and, therefore, would be no problem. That was not the case so now there is a problem with systems that cannot tell the year 1900 from the year 2000. The three areas impacted are:

- Desktop computers or personal computers and all the software that runs on them.
- Facilities and imbedded technologies. The facilities are buildings, and the imbedded technologies are the microcomputer chips on elevators, escalators, VCR's, cars, etc. The federal government estimates 1-2% of the chips will have a problem, and in one year 5 billion chips were shipped. At 2% that leaves about 100 million bad chips in the market each year.
- Data customers and data suppliers. Data customers are people to whom PERF sends data (a bank, another fund, etc.). A data supplier is an employer, for example, who is sending PERF information about their employees. If either are not year 2000 compliant, that information cannot be sent.

The potential problems include systems that shut down or will not come on at all, inaccurate calculations when dates are used, black outs and brown outs. There could also be security systems that malfunction and cars that quit running. Everyone seems to think that the problem will not start until January 2000. That, however, is not true — there are already problems. One agency had a date calculation that did not come out right and part of the data was purged from the data base. One Michigan grocery retailer experienced a shut down of their computers when they tried to process any credit card which expired in the year 2000 or after. Thus, there are already a lot of things going on and everybody is trying to do something to position themselves and minimize law suits.

On a national level, in February of 1998 President Clinton established the President's Council for Year 2000 Conversion. This group is responsible for making sure that the federal government is trying to address the year 2000 issues. There are 34 working groups in that Council and each group focuses on a specific area of business (small businesses, financial institutions, energy, etc.) The Council's goal is to have the federal systems ready by March 31, 1999 and to use the rest of 1999 for testing to make sure those systems are compliant. There is a three tier system they are using to determine how ready the federal government is. The first tier consists of agencies that need to make greater progress — they are not coming along very well at all. That includes the Department of Defense, Health & Human Services, Department of Education, and Department of Transportation. The second tier is comprised of those who are making progress, but they are substantially challenged. Those include the IRS and the Federal Financial Management System. The third tier consists of those making satisfactory progress and nearing completion. Those include the Social Security Administration, the EPA, the Federal Emergency Management Agency, and NASSA. A lot of those agencies started having problems several years ago and had to address the year 2000 problem early. Since this is a worldwide problem, the United States has contributed $12 million to the World Bank's efforts to raise awareness in other countries so that there are not international problems.

Also, on July 14 of this year President Clinton proposed the Year 2000 Good Samaritan legislation. There is no word to date as to whether that has been accepted. Without such legislation, companies are worried about liability if they tell another company that their product is year 2000 compliant or if they had a problem and share the fix they used but it doesn't work for the company with whom they share the information. This legislation would open up the sharing of good information and fixes for the year 2000 problem. In August 1998 the Securities Exchange Commission adopted rules that require broker/dealers and certain transfer agents to file reports regarding their year 2000 compliancy. There are also similar requirements for investment advisors in the works. The New York Stock Exchange has most of their system modifications made. They expect that they will all be completed by the end of 1998. Next year will be devoted to industry wide testing — during 1997 and 1998 they have been testing with individual participants.

On a state level, in 1996 a Year 2000 Office was established by the Data Processing Oversight Commission. The strategy of that office was to access all the State systems, analyze what the problems might be, and then remediate those systems to fix any year 2000 problems they found. The assessment was completed in 1996-97 which included an inventory of all the custom and commercial software, the hardware, and all the facilities in the State of Indiana. In May of 1997 the Budget Bill was passed which set aside $58 million to be spent on achieving year 2000 compliance over the next two years. The PERF estimated cost at that time was $1,658,703. To date, everyone is coming in under budget. One of the things that did happen was that some of the systems could not be repaired and were, therefore, replaced. When appropriations were requested, maintenance costs were not included. Therefore, in the legislative session this year it is expected that agencies will be requesting maintenance monies to maintain those systems they replaced. The Year 2000 Office has developed contract language to make sure nothing is purchased that is not year 2000 compliant. They are also requesting an opinion from the Attorney General's Office on the legal responsibilities for year 2000 issues. Some of those issues could include whether the State is liable or whether individuals or Boards are liable. To date, no word has been received from the Attorney General's Office on that issue.

At the PERF level, the main concerns are the computer hardware and software, data customers and suppliers, facilities, and the legal liabilities. Analysis was begun at the beginning of the year and completed in April on PERF's financial accounting management information system ("FAMIS"). Remediation is under way and is scheduled to be fully completed in January of 1999. Analysis on the Indiana Retirement Information System ("IRIS") was begun in February of this year. Part of the analysis had to be redone because of the new annuity option changes which included date changes. Completion of that project will now be bumped by a couple of months from January 1999 due to the reassessment that needs to be completed. There are five types of computers within the agency. All five of those have tested to be year 2000 compliant. The majority of the computer software is compliant. Upgrades to the Novel operating system and the Group Wise e-mail system are currently being procured so they will be year 2000 compliant as well.

The data suppliers and data customers have been identified, and a letter has been drafted to be mailed by September 4 which will provide documentation that everyone is, in fact, year 2000 compliant. All the phones and computer network wiring in the State have been evaluated by the Indiana Department of Administration's Information Services Division and Ameritech, and they are all compliant. The initial assessment of the facilities control found everything to be compliant.

Some of the legal issues which need to be identified are disclosure by investment managers and companies. Are there any legal responsibilities to tenants in PERF-owned buildings? What kind of documentation is needed to make sure that the Fund is legally covered? If benefits cannot be processed the first of January, what kind of legal ramification would there be? Those are the kinds of things that will be looked at over the next several months. Currently, everything is being documented — the status of what has been done, the compliancy found, the non-compliancy found and what has been done to address that, etc. It appears that if there is good documentation in place, it goes a long way to limiting your legal liability. But again, there is no guarantee that will cover the legal liability, so efforts will be made to insure such in the next few months. A contingency plan is also being structured wherein critical business systems will be identified and efforts made to make sure that things are in place to continue running those systems, whether that be manual processes or computer processes running from generators.

In summary, PERF looks very good and does not have any significant problems which need to be resolved. However, contingency plans will need to be put in place to prepare for the potential of utilities problems or whatever.

2. <u>BUREAU OF MOTOR VEHICLES COMMISSION UPDATE</u>

Mr. Webb reported that he and Mary Beth Braitman, Ice Miller Donadio & Ryan, had had several meetings with various personnel in the Bureau of Motor Vehicles Commission ("BMVC"). Essentially, what they wish to do is to terminate their defined contribution plan and come into PERF. The issue that the BMVC needs to decide is whether they want to come in as a new unit or whether they want to come in as a State enlargement. There are financial pro's and con's and ramifications of each of those decisions. They recognize that the ball is still in their court, but they feel that in the past week they have taken some really productive steps and have had some of the discussions that needed to take place. They are very hopeful that they will be able to bring this matter before the Board no later than its next meeting.

Chairman Doermer inquired if the BMVC currently determines every year what will go into their plan as a contribution plan. Ms. Braitman responded that it is a defined contribution formula and noted that it will be a very good story when they join PERF. It's similar to a story unfolding in Colorado where there were some defined contribution alternative plans available for public employers for a number of years which have not worked out very well either. So those plans are being folded back into the Colorado Public Employees' Retirement System. It is a very good example for Indiana as well where someone for 11 years has had a defined contribution plan which has not, in fact, worked out to everyone's satisfaction. The investment returns have not been nearly what it was felt they should have been. The accounts have not grown anywhere near what it was felt they should have grown. The accounting and record keeping have been either dismal or severely lacking. Both the employees and management are unhappy and see PERF's benefit structure as a far better one for them.

Chairman Doermer inquired further, "They'll turn over their funds to us, I assume?" Ms. Braitman responded that what has been proposed is to use the rollover provisions where the PERF actuaries would be deriving a cost two different ways. They would derive a cost for all BMVC service that was certified to them, so to buy up their total years of service would cost "X" dollars. They would also receive a current value of their defined contribution account and could buy "X" number of years of service in PERF if they wanted to use just those dollars. The defined contribution accounts won't bear any relationship to the service costs, so some people will have more than they need to buy all of their PERF years, some people will have less than they need, and virtually no one will have exactly the right amount. Everyone's hope is that as many people as can will buy up as much of that BMVC service so that they will have as complete a retirement package at the end of the day as they can.

3. PMOC/LEGISLATIVE AGENDA UPDATE

Ms. Braitman reported that once again the question of funding of the old police and fire funds is an issue. The 1977 Police & Fire Advisory Committee has been looking at where the next legislative session is likely to go in terms of the property tax reform/budget surplus/whatever else regular budget. The Advisory Committee is preparing a report that will go into the Governor's Citizens' Tax Commission study with the idea of looking at where funding will go and how much, if any, should go to fund additional dollars into the Pension Relief Fund. It is expected that there will be continued discussions about both the Teachers' Retirement Fund and the Police & Fire. Most people feel that the police and fire fund changes most recently legislated have been working out very well. In the last few years there has been an additional $50 million allocated one year with another $25 million and $25 million in the two-year biennium of another year. There was major legislation last year that moved the convertees into the 1977 Fund from the cities' and towns' unfunded liability position. So there is a momentum here and a very positive feeling in a lot of quarters that the changes that have been made have worked well and accomplished what they were supposed to accomplish.

Other legislation to be presented to the Pension Management Oversight Commission include bills concerning the following:

> Payment of Estimated Pension Benefits - Currently, benefits do not start until all compensation and service is finalized from any and all employers. This can (and does) result in delays in pension commencement. The Fund needs the ability to process

benefits on an estimate basis and then reconcile to a final benefit once that is established.

Designated Beneficiary Changes Post Retirement - Some flexibility would be granted to members, in certain cases, to change their designated beneficiary post retirement. The cases involve those in which there is a major life event (divorce, marriage) post retirement. Currently, once an individual commences retirement benefits there is no provision for changing the designated beneficiary. With this legislation, a person who has a marital change post retirement would be able to elect a new co-survivor, and the member's benefit would be adjusted to pay for the full cost of the new survivor.

Continued Annuity Savings Account Investment Post Retirement - Would allow a member to, in essence, split their pension from their annuity position, go into pay status on the pension side, and let their annuity savings account remain invested at their direction post retirement.

Small Benefit Cash Out - For administrative cost reasons, there is a need to add cash out if total (pension and annuity) benefit value is less than $200 and there has been no activity on the account for two (2) years. This would avoid the constant compounding of very small benefit values.

Earnings Cap During Reemployment While Receiving Retirement Benefits - PERF currently has a cap on how much a person can earn in a covered position while receiving benefits. Earning more than that cap results in a suspension of benefits and a reinstatement into active membership of PERF until the member re-retires. The index this is currently tied to is scheduled to rapidly increase in the next decade because of Social Security. The proposed change would make this cap a fixed amount.

Membership Records - PERF needs a reasonable enforcement mechanism in the event an employer is not providing timely reconciled contributions and membership information. Otherwise, in this new era of member investment direction, the Fund will be unable to timely invest a member's annuity savings account as the member directs. This legislation would request a reasonable penalty of $100 a day for late reports. This is a similar penalty imposed by the Teachers' Retirement Fund for lack of payment, and it has worked very well. They have gone from virtually the most haphazard compliance to 100% compliance.

1977 Police & Fire Fund Timing of Appeals - The 1977 Advisory Committee has agreed that it is reasonable to require some time lines for hearings on disabilities. There is currently at least one situation where an individual has been trying to schedule a hearing for over eight months. Cities and towns and police and fire all agree that there should be a requirement that a hearing will occur within 90 days of the member's request for hearing on disability. There would then be a 30 day period for the findings to be issued.

Dual Service - PERF has recently experienced some problems with respect to individuals who are working more than one full-time job. This provision would prohibit an individual from being in PERF if they are working in a PERF-covered position and also a position that is covered by another plan.

Annuity Savings Account Quarterly - PERF has spent considerable time working on the record keeping and accounting required by the new annuity savings account options. This bill would make certain necessary distribution changes to the payment provisions.

1977 Fund Portability Age Issue - The 1977 Fund Advisory Committee has worked on various "portability" issues inherent as more cities and towns seek to convert to 1977 Fund coverage for their public safety officers. One issue that arises with respect to officers being added to the 1977 Fund is what process should be used. Prior legislative efforts have addressed service purchases and other such issues, but there remains some concern regarding when the age restriction in IC 36-8-8-7 should be applied. This piece of legislation would clarify the situation to provide that in the case of a conversion to a 1977 covered unit, the age restriction would not be applied.

Judges' Service Purchases - Judges currently have the ability to purchase certain service (as a full-time commissioner, magistrate or referee). This legislation would allow judges to purchase PERF-covered service at full actuarial cost.

4. REPORT OF BENEFITS COMMITTEE

Speaking on behalf of the Benefits Committee, Teresa Ghilarducci noted that reports had already been made with respect to the absorption of the "convertees" from the 1925, 1937 and 1953 Police and Fire Pension Plans, the integration of the Bureau of Motor Vehicles Commission, the annuity savings accounts, the unit trust accounting system, the year 2000 compliance project, and the communications/education short-term projects.

However, an issue which still needs Board action concerns an item which arose in the Coopers & Lybrand report with respect to those individuals who had access to key PERF systems. When the job duties of individuals were reviewed with what they were actually doing, there was a lot of mismatch, and this was one area of mismatch that Coopers felt had potential problems of security. A lot of the mismatch evolved because of a lack of staffing, and individuals who were very able took over additional responsibilities. Coopers has recommended, the State Board of Accounts after reviewing the issue has recommended, the PERF staff has recommended, and the Benefits Committee also recommends that the security access and control of the benefits records be moved from the Accounting Department to the MIS staff.

MOTION duly made by Jonathan Birge, seconded by Nancy Turner, and unanimously carried to accept the Benefits Committee recommendation to move security access and control of the benefits records from the Accounting Department to the MIS staff.

Ms. Ghilarducci continued that action needs to be taken in three additional areas. One being the internal audit function which has been discussed to great length. Coopers and Lybrand prepared a proposal which has been reviewed by the Benefits Committee; however, there are a lot of questions concerning the cost, what happens to the report when it comes out of that internal audit, etc. Without an expectation that there will be sufficient staff to implement whatever comes out of that audit, then it does not make sense to go ahead with it. However, the Benefits Committee does know it is important and expects to have some kind of resolution of the matter by November. Chairman Doermer inquired if the issue was a question about the ability to continue to fund that function. Ms. Hamilton responded that Coopers had met with the Budget Director, and one of the concerns of the Budget Director was that PERF might spend as much as $300,000 on a consultant and yet still not have any trained staff on board at that point in time. Ms. Hamilton indicated that this is something on which the PERF staff should be working with the Budget Agency to determine what is in the best interest of the Fund in terms of an allocation of resources.

> Obviously, we've got staffing caps we need to deal with, but does it really make sense to get around a staffing cap by paying consultants $300,000? I can't tell you there aren't issues that need to be addressed, but I think there's kind of a sense that that didn't seem to make sense, but we needed to work through it in the context of the budget process and PERF's staffing issue.

Chairman Doermer inquired further if the feeling seemed to be that PERF would be starting with consulting in this area and phasing it out into an internal function. Ms. Hamilton responded affirmatively. She noted that the Budget Director felt an internal audit function is very important for PERF. The question is what's the best way to get that up and running that would, two years from now, leave the Fund in the best position.

Ms. Braitman noted that there has been discussion that it would make a great deal of sense for the Benefits Committee to assume the ongoing responsibility, as they have started in the internal audit field, and look at both the internal audit function as well as additional audit functions as suggested by Coopers and others. Chairman Doermer responded that it is not inappropriate that the Benefits Committee continue that role. The whole question of audit (internal, external, or mixed) would rest then with the Benefits Committee. It was also recommended that the Committee be retitled the Benefits Administration Committee.

5. INVESTMENT COMMITTEE REPORT

Speaking on behalf of the Investment Committee, Steve Miller reported that for the past several years one of the things the Board has requested from Prime Capital Management is to monitor the performance and compliance of the other managers. The Coopers and Lybrand report was pretty clear and pointed that that is not an appropriate thing for one manager to be doing. So discussion was undertaken with National City Bank, and it was determined that they are capable of providing the data on all the managers that would allow the monitoring of their compliance with the Board's investment policy. National City would not actually report or make any judgments on the compliance or initiate any action. They would simply provide PERF with a report, and the PERF consultants would be relied upon to follow up on any actions felt appropriate from that report. Thus, it is the Investment Committee's recommendation that National City Bank be retained to perform that function and immediately relieve Prime Capital Management of that responsibility.

Mr. Birge noted for the record that his law firm has, in the past, represented Prime Capital Management and, presumably, will continue to represent them on various matters. Thus, he felt he should abstain on any matters that relate to Prime.

MOTION duly made by Steve Miller, seconded by Teresa Ghilarducci and carried to delegate the monitoring of the portfolio managers' adherence to the investment guidelines to National City Bank. Jonathan Birge abstained from the vote.

MOTION duly made by Nancy Turner, seconded by Steve Miller and carried to recognize Lee Tanner for his work through the years for the Board of Trustees in overseeing the performance and compliance of the various money managers. Jonathan Birge abstained from the vote.

Mr. Miller continued that another Investment Committee meeting will be held in September and discussion will include the organization of Prime Capital Management, their performance, etc. At that time, a determination will be made on the disposition of assets now under their management going forward, and a contract will also be finalized for the next year. Thus,

MOTION duly made by Steve Miller, seconded by Nancy Turner and carried to delegate to Mark Webb the authority to execute a contract with Prime Capital Management once the Investment Committee has met with them and agreed upon a contract. Jonathan Birge abstained from the vote.

Chairman Doermer noted that there is somewhat of an awkward circumstance for Mr. Birge with regard to this subject. "It might best serve the Board if he did not serve on the Investment Committee. I think it would be a very constructive move in light of the circumstances at work here." Therefore, Mr. Birge was asked to serve rather on the Benefits Committee with Teresa Ghilarducci filling the Investment Committee position.

6. ADMINISTRATIVE MATTERS

Presentation on New Computer System

Diann Clift updated the Trustees with respect to a project which has been ongoing for about two years with the Teachers' Retirement Fund. PERF recently became involved in the project.

The objective of the project is to replace the Indiana Retirement Information System ("IRIS") currently used by PERF and the Teachers' Retirement Fund Information System ("TRFIS") with one integrated system which would allow both funds to meet current and future business needs more efficiently. One of the driving factors to doing this is that the TRFIS system was originally developed as a derivative of the IRIS system and never really met the needs of the Teachers' Fund very well. They have experienced some substantial cost in increasing functionality and basically maintaining the system over the years. They would like to reduce some of those costs. There will also be a wave of baby boomers retiring in a few years, and it is anticipated that the members projected to retire are expected to double in the next ten-year period from 1998 to 2008. Thus, there will be a much higher demand to process retirements more quickly in both funds. Another driving factor is the opportunity to reduce procurement costs for both agencies.

Reviewing the history of the project, work began in February of 1996. During 1996 the requirements for the Teachers' Retirement Fund were developed. PERF was not involved in the project at that time. A Request for Proposal ("RFP") was then issued for a system solution to replace the Teachers' system. They received four responses, began evaluation of those proposals, and held some additional demonstrations of systems during that year. In 1997 TRF tentatively selected Watson Wyatt Worldwide as the vendor they were going to use. They also realized that with the size of the project they might need some assistance in contract negotiations, project management oversight, and quality assurance. So they did another Request for Proposal to obtain some assistance with that.

In August of that year the Data Processing Oversight Commission ("DPOC") did approve the project with some conditions. Some of those conditions included that Teachers' did, in fact, have someone to help during negotiations and contract preparation, that they obtain some support with project management and quality assurance, that they also get some "price protection" for PERF so that if PERF wanted to replace their system in two to three years there would be some price guarantees for the cost of the system, and that delivery of and access to the source code be ensured if the company would have financial difficulties. At that time, DPOC authorized TRF to spend $5.4 million for the acquisition of the system.

In November of that year a contract for assistance was also awarded which allowed TRF to get project management negotiations and quality assurance folks on board to help out. Negotiations began with Watson Wyatt Worldwide in December. In January of 1998 it became apparent that the negotiations were not

going well. Unfortunately, the bidder had underscoped the development and acquisition costs, underscoped the outsourcing costs, and the business needs and required functionality were not clearly defined in the original RFP. With that they went back to the table and tried to refine the technical and outsourcing approaches, do some more demonstrations of the systems, and make sure they would meet their needs.
In April of that year the project was frozen with the acquisition costs at $11 million. All of the bidders were within 10% of each other, and they felt like they had actually come to a point that it really made some sense for everyone and was beginning to look like a true solution. However, the costs had gone from $5 million to $11 million, and the Budget Agency and several other folks felt there might be some economies of scale received with a reduction of costs by bringing PERF on board. So in May of that year some of the needs of PERF were analyzed in an effort to see if a cooperative project would be possible. Unfortunately, in June of 1998 Watson Wyatt Worldwide withdrew its proposal and became involved in a $30 million implementation project in Maryland. Thus, the project was given to Claremont Technologies. In July of this year Claremont, TRF and PERF spent a week going over all business functions and needs and tried to hash out what kind of things a system would need to do for each fund. It was realized during that time that the numbers of members, investments, and users tripled in size. The number of plans increased from 1 to 7, and there was also a need for investment accounting and record keeping added to the project which TRF did not originally include. In August it was also realized that there was no general ledger in the proposal, and that is a critical part of the business PERF needed provided. So the PeopleSoft Financial Accounting System was looked into. The State of Indiana has already purchased that system for implementation in the human resources and financials areas. They are implementing it with State Personnel, the Budget Agency, and some other agencies. PeopleSoft offered a general ledger module, and the system implementation costs were reduced by using licenses already in place. So that was brought on board in August as the addition to the Claremont.

Currently, additional costs of the project are being reviewed. Backfile conversion, wiring upgrades, and data conversion/cleansing costs were not identified in the actual costs of the project. All costs need to be identified before the approval process is pursued. PERF and TRF staff are working together to review proposed solutions, address all the concerns, and prepare documentation for the approval presentations. Current cost estimates are approximately $22-23 million with a breakdown as follows:

Acquisition of Business Application	-	$15 million
Four Years of Outsourcing	-	$4.9 million
Financial-General ledger	-	$.5-.7 million
Investment Accounting	-	$.7-1 million
Data Conversion/Clean-Up	-	$.5 million
Backfile Conversion/Indexing	-	$.5 million
Run Fiber to TRF/Upgrade Routers at PERF	-	$.1 million

It is critically important to point out that steps are being taken to minimize risks. All members of PERF's Management Committee have been involved in the decision making process thus far. Steps are being taken to work with TRF and to put steering committees in place. So if the project does go forward, a lot of effort has been made to ensure good communications and minimize the risks of the project.

Director Delegations

There are two separate issues to be brought before the Board. One concerns a responsibility with which the Board is charged to make a determination of the existence and degree of a disability. Pursuant to statute allowing them to do so, the Board has historically delegated the actual matter of conducting the hearings and issuing findings to the Director of the particular fund involved. It has been brought to staff's attention that there is no delegated authority to act in such matters with respect to the Judges' Benefit System. To date, there has been one disability paid from the Judges' System, and that individual was deceased about three years ago. There has now been another request for disability. Thus, it has been recommended that, as in all the other funds, the responsibility of making disability determinations for the Judges' Benefit System be delegated either to the Director of the Judges' Benefit System or to the PERF Director.

MOTION duly made by Steve Miller, seconded by Nancy Turner and unanimously carried to delegate the authority to make disability determinations for the Judges' Retirement System to the PERF Director or to such other person as he may deem appropriate to perform that function.

Secondly, there is current statute (IC 5-10.3-8-9) which prohibits the alienation attachment of any benefits paid by PERF of any kind. That includes the annuity savings account and pension benefits. There is a provision, however, that specifically permits the Board to transfer benefits to reimburse an employer for funds that were wrongfully taken by an employee if there is sufficient proof. The only sufficient proof acceptable under statute is a criminal conviction for either a felony or misdemeanor. PERF now has four such cases pending and awaiting action. The employees have been fired and legal holds have been placed on their funds at the request of the employers. Since statute does not specify how such cases are to be handled, the Attorney General's Office was consulted. Their response was that the Board of Trustees would need to convene for four different hearings and review evidence as to whether these benefits should be transferred or they could delegate that responsibility to another individual(s). Therefore,

MOTION duly made by Nancy Turner, seconded by Jonathan Birge and unanimously carried to delegate to the PERF Director the authority to determine whether sufficient evidence exists to deny a claim for refund in those cases where funds have been wrongfully taken and to order funds transferred to the appropriate entity. Such would allow an appeals process to ultimately bring these matters to a closure.

Town of Winslow Contribution Rate Issue

Bill Hutchinson, PERF Division Director of Pension Administration, explained that each year the Board of Trustees at the recommendation of the Fund's actuary (McCready & Keene) sets a contribution rate for the various governmental units. While most people are not always happy when those rates go up, there have been few cases when it has actually been questioned. In the case of the Town of Winslow, they sent PERF a letter indicating they would like to know why their rate was increased from 8% to 9%. That letter was passed on to the actuary, and they responded that upon reconsideration, 8% did not sound so bad. However, in order to change the rate, the Board would have to agree to do so since they approved the initial rate.

Mrs. Turner inquired if doing so would cause other entities to respond similarly. Mr. Hutchinson responded affirmatively and noted that another inquiry had already been received.

> That however, is not necessarily bad because mistakes can be made. McCready & Keene is an outstanding firm, and they are extremely careful. However, there is no way to prevent people from questioning. In this particular case, McCready has indicated, upon reconsideration, that the rate should be maintained at 8% for the 1999 year.

MOTION duly made by Jonathan Birge, seconded by Nancy Turner and unanimously carried to fix the Town of Winslow's employer contribution rate for 1999 at 8%.

Quarterly Financial Report

David Yeater, PERF Controller, distributed the attached Exhibit A for review by the Trustees.

Chairman Doermer inquired with respect to the 1998/99 budget for consultants of $1,155,510. "Did that figure evolve from discussions with the consultants or was it all an internal decision." Mr. Yeater responded that it was somewhat internal but by the same token the Board approves each contract.

Mr. Yeater continued that one of the biggest items which needed emphasis is that as the Fund goes to the quarterly preparation of employee statements of account as compared to annual statements, there will be a great increase in the amount of postage and printing expenditures. There has also been additional discussion of providing other correspondence to members, and each time a mailing is made it costs the Fund approximately $90,000 to $100,000. Thus, there will be an increase in that particular area of the budget by at least $500,000 to $600,000.

Building Update

Patrick Lane, PERF Executive Assistant to the Director, reported that occupancy in both of the PERF-owned buildings has remained the same. The property at 125 West Market Street is occupied by the Data Processing Oversight Commission who is working on the year 2000 issue for the State. That project will last well beyond the year 2000 so it is not anticipated that the Commission will be moving any time soon. The occupancy level at 143 West Market Street is at 85% and that's because the 7th floor is currently dormant in the fact that there are no renters. It is PERF's intention, once some staff reorganization is considered, to take on the 7th floor as well as the 5th, 6th, and 8th.

One notable accounts receivable is for over $15,000 and is due to the State of Indiana's slow turnaround time in pay at the beginning of the new fiscal year. Thus, that should be quickly resolved. There were some noticeable non-operating expenses incurred in May of over $19,000 and in June of over $26,000. Those expenses represented space improvements which were completed for the 3rd floor tenants as well as some improvements to some common areas and also some space planning and architectural fees for the 7th floor.

7. CONSIDERATION OF APPOINTMENT OF DIRECTOR

Doug Kinser, Executive Assistant to the Governor, reported to the Trustees concerning the search for a PERF Director. To date, there has been an interview process but the Governor's Office is not quite ready to make a recommendation to the Board of Trustees. They are hopeful to do so in the next month. They have interviewed a number of people internally and externally and feel comfortable in the direction they are going. However, there are just a lot of things yet to do.

8. BOARD EDUCATION

In previous Board meetings discussion was undertaken concerning the issue of the Board pursuing further education, not only in its fiduciary duty in terms of the investments of the Fund but also in its oversight of the administration of the agency. The discussions included the possibility of conducting an internal education process on a series of things which are still pending (proxy voting, international investing, etc.). While such a meeting had been scheduled, it became necessary to reschedule it for later this year or early next year. Beyond that, the Board had requested that Mary Beth Braitman and Mark Webb look at some information and gather materials in terms of trying to schedule some external education for the next year or so.

The first thing they wanted to bring to the Board's attention is the International Foundation of Employees' Benefits who annually puts on a large conference for public employees. This conference is very inclusive covering legislative regulatory developments, actuarial principles, an outlook on the stock market for the new millennium, issues in trustee ethics, and emerging fiduciary issues. It's a very well run program. The next meeting will be held in August of 1999.

Another International Foundation of Employees' Benefits conference is a new two-part certification program on public plan policy. It might be one that the Board would want to direct staff to attend rather than the Trustees. This program comes very, very highly recommended. It is conducted two days in August and another two days in October.

The Institution for International Research also offers a Trustee Education Forum which is directed to Trustees of public and multi-employer funds. Some of the topics include a primer to establish a solid foundation for sound investment decisions, defining and understanding your fiduciary responsibility, and investment policy and asset allocation. It is a very directed program.

Additionally, there is the Wharton School which is a wonderful primer solely for trustees. It is a significant commitment of time and resources. It is a 4-1/2 or 5 day program and is considered to be a superb training ground which is very much focused on trustees and their responsibilities. Some plans have actually mandated that their trustees attend the program. It is a very thorough Board education initiative.

9. NEXT MEETING DATE

The 4th quarter meeting of the Board of Trustees, previously set for November 30 and December 1, was rescheduled for December 14 and 15.

10. ADJOURNMENT

There being no further business, a Motion to adjourn was entertained and by unanimous vote the meeting was adjourned.